

DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 07-0206
Financial Institutions Tax
For The Tax Period 2002 - 2004

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Financial Institutions Tax – Imposition.

Authority: IC § 6-8.1-5-1(c); IC § 6-5.5-1-17(d)(2).

The Taxpayer protests the imposition of financial institutions tax.

II. Financial Institutions Tax – Indiana Income.

Authority: IC § 6-5.5-2-1(a); IC § 6-5.5-2-4; *Quill Corp. v. North Dakota*, 505 U.S. 298 (1992).

The Taxpayer protests the apportionment of Indiana income subject to the financial institutions tax.

STATEMENT OF FACTS

The Taxpayer is a regulated bank holding corporation. It is the reporting parent corporation for several subsidiaries. The Taxpayer's unitary group included several partnerships and limited liability companies during the audit period, 2002 - 2004. The Taxpayer's combined return included the apportioned income of the partnerships and limited liability companies. The Indiana Department of Revenue (Department) adjusted the Taxpayer's combined return by including the adjusted gross income of the partnerships and limited liability companies rather than the apportioned income. This adjustment resulted in additional financial institutions tax due for the audit period 2003 – 2004 and reduced net operating losses for the

tax year 2002. The Taxpayer protested the inclusion of a particular limited liability company (LLC) in the combined return and the Department's utilization of the pre-apportionment method in determining the income of the particular limited liability corporation to be included in the Taxpayer's combined financial institutions tax return. A hearing was held and a Letter of Findings was issued denying the Taxpayer's protest. The Taxpayer requested a rehearing on the following two issues: whether the purchase of loans which the LLC held for securitization purposes constituted the transaction of the business of a financial institution and whether the LLC transacted the business of a financial institution both within and without Indiana. A rehearing was held and this Supplemental Letter of Findings results.

I. Financial Institutions Tax – Imposition.

DISCUSSION

The Department determined that the LLC was subject to the Indiana financial institutions tax and should be included in the affiliated corporations' Indiana financial institutions combined tax return for the taxable years. The Taxpayer objected to the statement in the Letter of Findings that the LLC "transacts the business of a financial institution both within and without Indiana." The Taxpayer argues that the LLC did not conduct the business of a financial institution in Indiana or elsewhere.

The first issue to be determined is whether or not the LLC conducted the business of a financial institution.

All tax assessments are presumed to be valid. IC § 6-8.1-5-1(c). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

Transacting the "business of a financial institution" is defined at IC § 6-5.5-1-17(d) (2) as follows:

(2) For any other corporation described in subsection (a)(4), all of the corporation's business activities if eighty percent (80 [percent]) or more of the corporation's gross income, excluding extraordinary income, is derived from one (1) or more of the following activities:

- (A) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include:
 - (i) secured or unsecured consumer loans;
 - (ii) installment obligations;
 - (iii) mortgage or other secured loans on real estate or tangible personal property;
 - (iv) credit card loans;
 - (v) secured and unsecured commercial loans of any type

- (vi) letters of credit and acceptance of drafts;
- (vii) loans arising in factoring; and
- (viii) any other transactions with a comparable economic effect.

(B) Leasing or acting as an agent, broker, or advisor in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes.

(C) Operating a credit card, debit card, charge card, or similar business.

The Taxpayer argued that the LLC did not receive at least 80 percent of its income from any of the listed activities. According to the Taxpayer, the LLC's interest income was generated solely through the holding of loans – not a listed activity subjecting a taxpayer to the financial institutions tax.

The Taxpayer and the Department agreed that the LLC did not earn income from making loans. There is no indication that the LLC earned income from selling the loans. The remaining listed activities subjecting a taxpayer to the financial institutions tax are the acquisition and servicing of loans. According to the Taxpayer, only the acquisition of loans at a discounted rate generates income. Since the LLC acquired the loans at face value, the Taxpayer argued that the LLC did not receive income from the acquisition of the loans. Finally, the Taxpayer argued that the LLC did not earn any income from servicing the loans since one of the Taxpayer's affiliated banks serviced the loans for a fee. Therefore, the Taxpayer argued that the LLC did not earn income from any of the listed activities – making, acquiring, selling, or servicing loans. The Taxpayer contended that the LLC earned its income from an unlisted activity, holding loans. Since the LLC did not earn its income from any of the listed activities, the Taxpayer argued that the Department improperly imposed the financial institutions tax.

The Taxpayer's argument is disingenuous. Without acquiring the loans, the LLC could not have received any interest income from the loans it held. The LLC also could not have generated any income from holding the loans unless they were serviced. The LLC could either service the loans itself or contract with another entity to service the loans for the LLC. The LLC chose to contract with the affiliated bank to service the loans. The LLC's holding of the loans would not have generated any income if the LLC had not acquired the loans or contracted to have them serviced by the affiliated bank. The acquisition of the loans and contracting with the affiliated bank to service the loans were integral parts of the LLC's income producing activities. The LLC transacted the business of a financial institution as defined at IC § 6-5.5-1-17(d)(2).

FINDING

The Taxpayer's protest is respectfully denied.

II. Financial Institutions Tax – Indiana Income.

DISCUSSION

The Department determined the amount of the LLC's Indiana income subject to the financial institutions tax. The Taxpayer protested the assessment contending that none of the LLC's income derived from business activities in Indiana.

The issue to be determined is whether or not the LLC had Indiana income subject to the financial institutions tax.

The financial institutions tax is imposed and computed pursuant to IC § 6-5.5-2-1(a) as follows:

There is imposed on each taxpayer a franchise tax measured by the taxpayer's apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana. The amount of the tax for a taxable year shall be determined by multiplying eight and one-half percent (8.5 [percent]) times the remainder of:

(1) the taxpayer's apportioned income; minus

. . .

"Taxpayer's apportioned income," is defined at IC § 6-5.5-2-4 as follows:

For a taxpayer filing a combined return for its unitary group, the group's apportioned income for a taxable year consists of:

- (1) the aggregate adjusted gross income, from whatever source derived, of the members of the unitary group; multiplied by
- (2) the quotient of:
 - (A) all the receipts of the taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by
 - (B) the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions.

The Taxpayer contended that since the LLC had no income deriving from transactions in Indiana, the LLC's share of the numerator of the apportionment fraction would be zero. With a zero in the numerator for the LLC, there would be no LLC income subject to the Indiana financial institutions tax. In support of its contention, the Taxpayer stated that the LLC's office, employees, and property were in Michigan and the LLC's only physical presence in Indiana was infrequent Board of Directors' meetings held in South Bend. Since its only physical presence in Indiana was Board of Directors' meetings, the Taxpayer argued that the LLC did not have adequate nexus with Indiana to subject it to Indiana financial institutions tax.

The Taxpayer errs in this conclusion. In *Quill Corp. v. North Dakota*, 504 U.S. 298, 306 (1992), the Supreme Court stated that “[t]he Due Process Clause ‘requires some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax.’” However, the Court concluded that the due process requirement is satisfied “if a foreign corporation purposefully avails itself of the benefits of an economic market in the forum state . . . even if the [taxpayer] has no physical presence in the state.” *Id.* At 307. Although the LLC’s physical existence – measured by its business location and employees – is in Michigan, the LLC has directed its activities at the residents of Indiana and at the benefits conferred by Indiana. The LLC purchased loans made in Indiana to the citizens of Indiana. The fact that Indiana confers protection, benefits, and opportunities upon the LLC is apparent from the LLC’s ability to derive income from the purchase of loans made in Indiana by its affiliated banks located in Indiana. The contractual relationship of the LLC to its affiliated Indiana banks which make loans to Indiana citizens created the requisite nexus with Indiana necessary for Indiana to subject the LLC to the Indiana financial institutions tax. The interest income earned from Indiana loans derived from Indiana sources and is subject to the financial institutions tax.

FINDING

The Taxpayer’s protest is respectfully denied.

KMA/LS/DK – January 29 , 2008